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-----057437 101746Z /73

P R 101400Z MAR 78
FM AMEMBASSY STOCKHOLM
TO SECSTATE WASHDC PRIORITY 3260
DEPARTMENT OF TREASURY PRIORITY
INFO AMEMBASSY ANKARA
AMEMBASSY ATHENS
AMEMBASSY BERN
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AMEMBASSY BRUSSELS
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E.O. 11652: GDS
TAGS: EFIN, SW, OECD
SUBJECT: THE SWEDISH ECONOMY IS READY TO JOIN THE OECD "CONVOY"

REFS: A) 77 STOCKHOLM 3727, B) 77 STOCKHOLM A-188

1. SUMMARY. WE ARE PLEASED TO NOTE THE APPARENT DECISION OF THE USG TO ABANDON THE "LOCOMOTIVE ECONOMIES" CONCEPT (AS WE READ PARIS 799). WE SUPPOSE SWEDEN IS INCLUDED IN THE "CONVALESCENT" GROUP OF COUNTRIES. EMBASSY IS PREPARED TO ARGUE THAT ROOM FOR EXPANSION EXISTS IN THE SWEDISH ECONOMY, DESPITE A VARIETY OF DOOMSDAY REPORTS WHICH HAVE APPEARED IN THE WORLD PRESS OVER THE LAST 12 TO 24 MONTHS. AS SWEDEN WILL PRESUMABLY BE THE FIRST NATION REVIEWED IN THE EDRC (MARCH 15) AFTER THE RECENT ECONOMIC POLICY COMMITTEE DISCUSSIONS, THIS SHOULD BE AN AUSPICIOUS TIME TO BEGIN TO PRESSURE ALL OF THE SMALLER OECD COUNTRIES TO "DO THEIR PART." IN FACT, SWEDISH EXPORTS SEEM TO BE DOING BETTER RIGHT NOW THAN MIGHT HAVE BEEN EXPECTED SO SOON AFTER THE AUGUST DEVALUATION AND AT THIS STAGE OF THE INTERNATIONAL BUSINESS CYCLE. THE RATE OF INFLATION, THOUGH UNACCEPTABLY HIGH, IS PRIMARILY A RESULT OF COST PRESSURE AND SPECIFIC GOVERNMENT ACTIONS: DEVALUATION AND VALUE ADDED TAX INCREASES IN 1977. TOTAL DEMAND IS FORECAST TO DECLINE IN REAL TERMS BY AROUND 2.5 PERCENT IN 1978, CAPACITY UTILIZATION IS RUNNING AT LESS THAN 85 PERCENT (IN A COUNTRY WHERE 98 PERCENT IS NOT UNUSUAL), AND LABOR NEGOTIATIONS COULD WELL SEE HOURLY WAGES INCREASE BY NO MORE THAN TWO PERCENT IN 1978 AND TOTAL LABOR COSTS BY NO MORE THAN TEN PERCENT. THIS SHOULD ALLOW THE GOVERN-
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MENT TO FOLLOW A MORE EXPANSIONARY STANCE THAN IT NOW PLANS.

2. AN EASING OF RESTRAINTS WOULD DETERMINE WHETHER SWEDEN'S IMPORT VOLUME IN 1978 WILL BE OVER ONE PERCENT LESS RPT LESS THAN IN 1977 (NATIONAL INCOME ACCOUNTS) OR WILL REGISTER SOME REAL GROWTH. THE NOMINAL GROWTH RATE OF IMPORTS IN STRAIGHT BALANCE OF PAYMENTS TERMS IS FORECAST AT AROUND 8.5 PERCENT, BUT COULD BE EVEN LESS IF, AS WE BELIEVE, PRICE ELASTICITY OF DEMAND HAS BEEN UNDERESTIMATED AS IT WAS IN 1975-77. EMBASSY RECOMMENDS, WITH CAVEATS, THAT SWEDEN BE ENCOURAGED TO ALLOW A GRADUALLY MORE EXPANSIVE FISCAL AND MONETARY POLICY TO DEVELOP IN THE MIDDLE QUARTERS OF 1978. AS SWEDEN'S PRIME POLICY GOAL IS FULL EMPLOYMENT, THEY MAY BE MORE AMENABLE TO THIS ARGUMENT THAN OTHER COUNTRIES. END SUMMARY

3. AT A TIME WHEN INTERNATIONAL COORDINATION OF MACRO-ECONOMIC POLICY SEEMS TO BE FLOUNDERING, IT SEEMS TO US MOST APPROPRIATE TO EXAMINE THE PART EACH INDUSTRIAL ECONOMY PLAYS IN THE OECD WHOLE, AND TO EMPHASIZE

RECIPROCAL RESPONSIBILITIES AND INTERDEPENDENCE. SWEDEN
MAY BE A USEFUL EXAMPLE IN THIS CONTEXT. THE
PRESS SEEMS TO HAVE HELD UP THE PROSPECTIVE FAILURE
OF SWEDEN'S SUPPOSED MODEL SYSTEM WITH CONSIDERABLE
GLEE, IGNORING THE FACT THAT THE UNEMPLOYMENT RATE
HAS BEEN HELD BELOW TWO PERCENT. THE GOVERNMENT HAS
ALSO EMPHASIZED SWEDEN'S PROBLEMS WITH INFLATION AND
EXTERNAL DEFICIT, PARTICULARLY FROM REAL CONCERN, BUT
ALSO IN AN ATTEMPT TO TONE DOWN LABOR DEMANDS. BUSINESS
LEADERS HAVE SOUNDED OUT LOUDLY AND CLEARLY ON
THEIR INABILITY TO COMPETE. PRIMARY POLICY RESPONSES
WERE TIGHT MONEY, DEVALUATION, INCREASE IN THE VALUE
ADDED TAX, AND OTHER SPECIFIC MEASURES WHICH, WHEN
ADDED TO SLACK DEMAND ABROAD, RESULTED IN AN ACTUAL
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DECLINE IN REAL TOTAL DEMAND OF 2.5 PERCENT IN 1977.

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DEPARTMENT OF TREASURY PRIORITY

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THE FORECAST FOR 1978 IS MINUS 0.1 PERCENT. RESTRICTIONS IN DEMAND AND HIGHER IMPORT PRICES LED NATURALLY TO A CURTAILMENT OF IMPORTS IN 1977, AND THE FORECAST FOR 1978 IS FOR A FURTHER DECLINE OF 1.3 PERCENT IN VOLUME. ALTHOUGH THE MINISTRY OF ECONOMY HAS REVISED UPWARDS SOMEWHAT ITS ESTIMATES FOR PRICE ELASTICITIES OF DEMAND FOR IMPORTS, AND HAS REVISED IMPORT PROPENSITIES DOWNWARDS TO ALLOW FOR INCOME EFFECTS, WE STILL BELIEVE THEY MAY HAVE UNDERESTIMATED THE LIKELY DECLINE IN IMPORT VOLUME IN ORDER TO KEEP PRESSURE ON THE LABOR MARKET. THE POINT HERE IS, OF COURSE, THAT IF TOTAL OECD DEMAND FOR EXPORTS IS TO INCREASE SIGNIFICANTLY, EVEN A SMALL DECREASE SUCH AS THAT BROUGHT ABOUT BY SWEDISH ACTION (IF REPEATED BY MANY OF THE SMALLER INDUSTRIAL NATIONS) CAN HAVE FAR-REACHING REPERCUSSIONS.

4. COULD SWEDEN ACT OTHERWISE? HOW SERIOUS ARE THE SIAMESE TWIN PROBLEMS OF INFLATION AND EXTERNAL BALANCE? WITHOUT IN ANY WAY DETRACTING FROM THE SERIOUSNESS OF

THE PROBLEMS, WE ARE PREPARED TO ARGUE THAT SWEDEN CAN CONTRIBUTE TO AN ACCELERATION OF THE RECOVERY OF TOTAL OECD EXPORT DEMANDS.

5. THE CONSUMER PRICE INDEX IN DECEMBER 1977 WAS 14 PERCENT HIGHER THAN IN DECEMBER 1976. THE AVERAGE CPI OF 1977 WAS 11.2 PERCENT ABOVE 1976. MUCH OF THIS INFLATION WAS, HOWEVER, SELF-INFLICTED. THE GOVERNMENT RAISED THE ANNUAL AVERAGE RATE BY AT LEAST ONE PERCENTAGE POINT WHEN IT RAISED THE VALUE ADDED

TAX BY THREE PERCENT IN APRIL 1977. SUCCESSIVE DE-
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VALUATIONS ADDED ANOTHER THREE PERCENTAGE POINTS BY OUR CALCULATIONS, AND A GOOD PART OF THE DEVALUATION EFFECT HAS NOT YET WORKED ITS WAY INTO THE INDEX. NEVER-THELESS, THE POINT IS THAT THE COST OF LIVING MIGHT HAVE GONE UP BY LESS THAN NINE PERCENT IF THE GOVERNMENT HAD CHOSEN OTHER POLICY TOOLS (THE FORECAST FOR 1977, EIGHT PERCENT, MIGHT EVEN HAVE BEEN REACHED). ONE INDICATION OF THIS IS THAT EXPORT PRICES, THE KEY INDEX IN MANY WAYS, ROSE BY OTHER SIX PERCENT BETWEEN DECEMBER 1976 AND DECEMBER 1977.

6. IT ALSO APPEARS CONCLUSIVE THAT INFLATION IN SWEDEN HAS BEEN PUSHED UPWARDS BY COST ESCALATIONS, NOT PULLED ALONG BY DEMAND. THE RAPID INCREASES IN LABOR COSTS BETWEEN 1974 AND 1975 (42 PERCENT) ARE STILL FINDING THEIR WAY INTO PRICE INCREASES. YET, TOTAL DEMAND IN 1975, 1976 AND 1977 REGISTERED REAL GROWTH RATES OF 0.0, 2.8 AND MINUS 2.6 PERCENT, RESPECTIVELY. CAPACITY UTILIZATION WAS AROUND 87 PERCENT IN 1977, AND IS EXPECTED TO BE LESS THAN 85 PERCENT THIS YEAR. THIS CONTRASTS WITH 98 PERCENT IN 1973 AND 100 PERCENT IN 1974. THE ONLY VALUE TO DEMAND MANAGEMENT AS A POLICY TOOL WITH WHICH TO CONTROL SWEDISH INFLATION IS THE SECONDARY EFFECT ON LABOR DEMANDS.

7. THIS YEAR THERE IS EVERY REASON TO BELIEVE THE UNIONS WILL SETTLE FOR AN INCREASE IN HOURLY WAGES OF AROUND TWO PERCENT. FURTHERMORE, THERE WILL BE NO INCREASE IN PAYROLL TAXES ON EMPLOYERS (NOW ABOUT 40 PERCENT OF TOTAL WAGES AFTER A STEADY SUCCESSION OF INCREASES). WHEN THE COSTS OF A FIFTH LEGAL WEEK OF VACATION, WAGE DRIFT, ETC., ARE ADDED IN, TOTAL WAGE COSTS SHOULD RISE BY NO MORE THAN TEN PERCENT IN 1978 OVER 1977. IF THE FIVE PERCENT INCREASE IN PRODUCTIVITY WHICH INDUSTRY EXPECTS IS REALIZED, UNIT
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LABOR COSTS WILL HAVE PERFORMED WELL VIS-A-VIS SWEDEN'S COMPETITORS. AN ADDITIONAL IMPORTANT POINT: LABOR HOARDING, WHETHER VOLUNTARY FOR PRIVATE MOTIVES OR STIMULATED BY LABOR MARKET POLICY SUCH AS THE 25 KRONOR PER HOUR TRAINING SUBSIDY, MEANS THAT A CONSIDERABLE

"PRODUCTIVITY RESERVE" EXISTS IN THE ECONOMY. PUTTING

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TO WORK UNDERUTILIZED LABOR COULD MEAN PRODUCTIVITY INCREASES WHICH ARE ESTIMATED AT ANYWHERE BETWEEN 8 AND 15 PERCENT WITHOUT RECRUITMENT, TRAINING, ETC., COSTS. THUS AN EXPANSION OF SWEDISH OUTPUT CAN BE DEFENDED AS ANTI-INFLATIONARY.

8. THIS DOES NOT MEAN THAT IN ANNUAL AVERAGES THE 1978 RATE OF INFLATION WILL BE SIGNIFICANTLY LOWER THAN THE 1977 RATE. BY THE TIME THE DEVALUATION HAS HAD ITS FULL IMPACT THERE MAY BE MINIMAL IMPROVEMENT. BY THE SECOND HALF OF THE YEAR, HOWEVER, A DECELERATION SHOULD BE CLEARLY VISIBLE. MORE IMPORTANTLY, THERE IS NO REASON TO BELIEVE AN EXPANSIONARY POLICY WILL INCREASE THE RATE OF INFLATION.

9. ON THE EXTERNAL ACCOUNTS SIDE, SWEDEN HAS DONE BETTER THAN ANYONE EXPECTED. DESPITE THE WELL-KNOWN J-CURVE EFFECT OF DEVALUATION, THE TRADE DEFICIT IN 1977 WAS ONLY 4.6 BILLION KRONOR INSTEAD OF THE 7 BILLION PLUS WHICH THE GOVERNMENT WAS EXPECTING AS LATE AS DECEMBER. (OUR SEPTEMBER FORECAST OF A 5 BILLION KRONOR DEFICIT WAS ACTUALLY MORE ACCURATE THAN THE PRELIMINARY FIGURES THE GOVERNMENT RELEASED IN ITS "SWEDISH ECONOMY" OF JANUARY: 5.7 BILLION.)

10. AS WE EMPHASIZED MOST RECENTLY IN REF B, ECONOMIC TRENDS REPORT, SWEDEN'S TRADE PROBLEMS ARE PRIMARILY IN ENERGY (A SKR 13.5 BILLION TOTAL OIL BILL IN 1976); IN SLACK DEMAND IN SPECIFIC TRADING PARTNERS AND COMPETITORS (THE TOTAL DEFICIT WITH GERMANY AND JAPAN WAS OVER NINE BILLION KRONOR IN 1976); IN RELATIVE DEMAND INEQUALITIES DURING 1975-76; AND IN TERMS

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OF TRADE (SUDDEN INCREASES IN PRICE OF MANY IMPORTED RAW MATERIALS IN 1976-77, COMBINED WITH LOWER PRICES OF SWEDISH EXPORTS SUCH AS IRON ORE MORE THAN OFFSET OPPOSITE BENEFICIAL EFFECTS WHICH TOOK PLACE IN 1975-75 AND LEFT A "RAW MATERIALS" TRADE DEFICIT OF OVER 13 BILLION KRONOR IN 1977). SWEDEN'S RECORD IN EFFICIENCY OF ENERGY USAGE IS ABOUT AS GOOD AS ANY INDUSTRIAL NATION SO NO GREAT IMPROVEMENT CAN BE EXPECTED IN THAT AREA. TERMS OF TRADE CAN ONLY DECLINE IN THE SHORT-TERM, DUE TO THE DEVALUATIONS. ON THE EXPORT SIDE, WE SEE NO REASON TO SCRAP THE TRADITIONAL WISDOM THAT SWEDEN'S EXPORTS LAG THE INTERNATIONAL BUSINESS

CYCLES. IF INVESTMENT ACTIVITY IN THE FRG, THE UK, ITALY, ETC. BEGINS TO DO WELL THIS YEAR, AS SOME REPORTS SUGGEST, SWEDISH PROSPECTS SHOULD IMPROVE, BUT THEY HAVE ALREADY DONE BETTER THAN THE "WISDOM" MIGHT HAVE LED ONE TO BELIEVE. BY NOVEMBER, INCOMING ORDERS FOR MANUFACTURED EXPORTS (EXCLUDING SHIPBUILDING) WERE GROWING MORE THAN TWICE AS FAST AS TOTAL ORDERS FOR MANUFACTURED GOODS. IN THE FINAL FOUR MONTHS OF THE YEAR EXPORTS WERE SOME 14 PERCENT ABOVE THE SAME PERIOD OF 1976 (6 PERCENT REAL GROWTH). SIMULTANEOUSLY, IMPORTS DROPPED BY SOME TEN PERCENT IN VOLUME. FOR THE NOVEMBER-JANUARY PERIOD THE SWEDES ACTUALLY RECORDED A SURPLUS OF ABOUT 200 MILLION KRONOR. THIS RESULT PRECEDES FAVORABLE EFFECTS OF THE TEN PERCENT AUGUST DEVALUATION WHICH IS ONLY NOW PLAYING A ROLE.

11. NONE OF THIS SHOULD BE TAKEN TO IMPLY THAT SWEDEN'S PROBLEMS HAVE DISAPPEARED OR WILL DISAPPEAR. TOURISM EXPENDITURES SHOW NO SIGN OF DROPPING OFF DESPITE THE DEVALUATIONS. THEIR FOREIGN AID COMMITMENT APPEARS SOLID, AND FOREIGN BORROWINGS OF THE PAST THREE YEARS WILL REQUIRE SUBSTANTIAL INTEREST PAYMENTS BEGINNING THIS YEAR. NEVERTHELESS, WE CONCLUDE THAT THE BALANCE

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OF PAYMENTS CONSTRAINT HAS EASED CONSIDERABLY. THE CURRENT ACCOUNT DEFICIT WAS ONLY 14.8 BILLION KRONOR VERSUS 16 PLUS IN THE PRELIMINARY FIGURES IN JANUARY. FOREIGN EXCHANGE RESERVES REFLECT THIS EASING: INCLUDING OFFICIAL 1977 BORROWING ABROAD OF SOME

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SKR 9 BILLION, TOTAL RESERVES EXCEEDED 18 BILLION KRONOR IN LATE 1977 AND HAVE INCREASED BY 8.6 BILLION KRONOR SINCE 1972. THIS REPRESENTS A HIGH (FOR SWEDEN) 20 PERCENT OF TOTAL IMPORTS. WE ALSO BELIEVE THAT DESPITE THE SIZABLE FOREIGN BORROWINGS OF 1975, '76, '77 SWEDEN IS STILL A "NET FOREIGN CREDITOR" (IF A CURRENT MARKET VALUE IS GIVEN TO OFFICIAL GOLD HOLDINGS).

12. THE PUBLIC SECTOR ROLE IN OVERALL NATIONAL INCOME DEVELOPMENT, DESPITE WIDESPREAD PUBLIC OUTCRY AT THE "HUGE" NATIONAL BUDGET DEFICIT OF 33 BILLION KRONOR, HAS NOT BEEN OUT OF LINE. IN FACT, WHEN SURPLUSES OF THE SOCIAL SECURITY SYSTEM AND LOCAL GOVERNMENTS ARE COUNTED, THE CONSOLIDATED PUBLIC SECTOR SHOWS A DEFICIT OF ONLY 3.6 BILLION. IF LENDING FINANCED BY THE GOVERN-

MENT BUDGET IS INCLUDED, THE DEFICIT IS STILL ONLY 15.6 BILLION, HARDLY LARGE GIVEN THE UNAVOIDABLE SUPPORT MEASURES FOR EMPLOYMENT AND INDUSTRY.

13. WHEN ALLOWING FOR INDIRECT EFFECTS (E.G. INCREASED TRANSFER PAYMENTS, INDUSTRIAL SUBSIDIES) AND LAGGED EFFECTS (PAST SUBSIDY OF INVENTORY ACCUMULATION NOW MEANS STOCKS MUST BE DRAWN DOWN: A NEGATIVE IMPACT), AND DIFFERING IMPORT AND CONSUMPTION EXPENDITURES IN SECTORS AFFECTED BY FISCAL POLICY, THE MINISTRY OF ECONOMY CALCULATES OVERALL FISCAL POLICY WILL HAVE A STIMULATING EFFECT IN 1978 OF ONLY 2.8 PERCENT OF GDP. THE FIGURE WAS 2.9 PERCENT IN 1977 AND 1.3 IN 1976. GIVEN A VOLUME DECLINE OF 2.5 PERCENT IN GDP IN 1977, AND THE DANGER THAT PRIVATE CONSUMPTION WILL DROP AGAIN IN 1978, THIS DOES NOT STRIKE US AS LARGE AT ALL. THIS
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IS ESPECIALLY TRUE IN SWEDEN WHERE TRANSFER PAYMENTS ARE 60 PERCENT OF NATIONAL GOVERNMENT EXPENDITURE, AND THE COMMITMENT TO FULL EMPLOYMENT PRECEDES ALL OTHER ECONOMIC POLICY TARGETS.

14. THERE IS ALSO A POSSIBILITY THAT THE GOVERNMENT MAY HAVE UNDERESTIMATED THE DECLINE IN PRIVATE CONSUMPTION IN 1978 (1.5 PERCENT IN VOLUME TERMS). LAST YEAR, AS A RESULT OF TAX INCREASES, DEVALUATION, HIGH INFLATION, ETC., THE SAVINGS RATE JUMPED TO 11 PERCENT. ALTHOUGH WE WOULD SHARE THE GOVERNMENT'S VIEW THAT THIS CANNOT CONTINUE, THERE IS STILL A GOOD CHANCE THAT SAVINGS WILL REMAIN FAIRLY HIGH AND THAT WITH REAL DISPOSABLE INCOME EXPECTED TO DECLINE BY 2 PERCENT OR MORE PRIVATE CONSUMPTION MAY DECLINE BY 2 PERCENT OR MORE. THIS WOULD FURTHER REDUCE THE VOLUME OF IMPORT GROWTH. IF EXCESS STOCKS ARE RUN DOWN MORE RAPIDLY THAN THE GOVERNMENT EXPECTS, ANOTHER DEFLATIONARY EFFECT OF PERHAPS 0.5 PERCENT OF GDP COULD BE FELT.

15. WHERE CAN OR SHOULD THE GOVERNMENT PROVIDE STIMULUS SO AS TO MAINTAIN ITS PLACE IN AN "INTERNATIONAL CONVOY" OF INDUSTRIAL ECONOMIES? INVESTMENT WILL DROP BY AT LEAST ONE PERCENT IN 1978 AND INDUSTRIAL INVESTMENT BY AROUND 15 PERCENT, ACCORDING TO CURRENT PLANS. WE BELIEVE LITTLE CAN BE DONE TO CHANGE THE LATTER, UNTIL INTERNATIONAL PROSPECTS CAN BE SAID IRREVOCABLY TO HAVE IMPROVED. EXTREMELY HIGH LEVELS OF INVESTMENT IN 1974, '75 AND '76 CASTS CONSIDERABLE DOUBT ON ANY IMMEDIATE NEED FOR SUCH INVESTMENT NOW, ESPECIALLY WITH CURRENT CAPACITY UTILIZATION LEVELS. (COUNTER-CYCLICAL INVESTMENT RESERVES NOW AVAILABLE

ARE NOT BEING USED, DESPITE ARGUMENTS THAT INFLATION
IS EATING AWAY THEIR VALUE.) AT THE SAME TIME, HOUSING
CONSTRUCTION HAS FALLEN DRASTICALLY IN SWEDEN, AND
SURPLUSES OF THE EARLY 70'S HAVE NOW TURNED INTO
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SHORTAGES. SOME MOVEMENT HAS ALREADY BEEN MADE TO
STIMULATE THIS SECTOR, APPARENT IN LATE 1977, BUT
MORE COULD BE DONE. A VARIETY OF BUSINESS AND ACADEMIC
ECONOMISTS HAVE ADVOCATED A DECREASE IN THE
PAYROLL TAXES PAID BY EMPLOYERS TO FINANCIAL SOCIAL WEL-
FARE. THEY BELIEVE THE IMPACT WOULD MEAN A LESSENING

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OF LABOR COSTS AND AN INCREASE IN PROFITS, ERGO BETTER INVESTMENT PROSPECTS FOR 1979. OTHERS HAVE ARGUED FOR DECREASES IN DIRECT INCOME TAXES OR A REDUCTION IN THE VAT. IT IS PROBABLE THAT ALL THESE TAX SUGGESTIONS ARE POLITICALLY UNACCEPTABLE IN DIFFERING DEGREE AND KIND EITHER TO LABOR OR TO THE CONSERVATIVE WING OF THE CURRENT GOVERNING COALITION. NEVERTHELESS, IT WOULD SEEM DESIRABLE FOR THE GOVERNMENT TO SEEK SOME WAY TO EASE RESTRICTIONS ON PRIVATE CONSUMPTION. (NOTE IN OUR ECONOMIC TRENDS REPORT, REF B, THAT WE CONTINUE TO BELIEVE PRIVATE CONSUMPTION MUST BE HELD UNDER 1.5 PERCENT PER ANNUM IN VOLUME TERMS IF SWEDEN IS TO ACHIEVE MEDIUM TERM BALANCE EXTERNALLY IN THE MID-1980'S.)

16. THE RIKSBANK HAS ALREADY ACTED TO EASE MONETARY POLICY SLIGHTLY BY DROPPING THE REDISCOUNT RATE FROM EIGHT PERCENT TO 7.5. STILL, CREDIT CEILINGS FOR COMMERCIAL BANKS, RIGID DIRECT CONTROL OF THE BOND MARKET AND TIGHT RESTRICTIONS ON CONSUMER CREDIT COULD BE RELAXED A GOOD BIT.

17. AFTER THE EXTENSIVE GOVERNMENT JAWBONING AIMED AT CONTROLLING LABOR COSTS, AND THE PAST LITANY OF BUEINSSS COMPLAINTSN IT WILL CERTAINLY BE DIFFICULT FOR THE GOVERNMENT TO TAKE ANY STRONG ACTION. NEVERTHELESS, WE BELIEVE THEY CAN AND SHOULD BE ENCOURAGED TO EASE OFF ENOUGH TO ALLOW IMPORTS TO REGISTER SOME REAL GROWTH IN 1978. IN FOLLOWING SUCH A COURSE WE MUST KEEP IN MIND TWO SWEDISH ATTITUDINAL CONSTRAINTS. THEY ARE ESPECIALLY CONCERNED ABOUT DEVELOPMENTS IN THE EXPOSED SECTOR (EXPORT OR IMPORT-COMPETING) VERSUS THE SHELTERED
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SECTOR. FOR MEDIUM AND LONG TERM REASONS THE SWEDES CANNOT SET IN TRAIN AN INCREASED DEMAND FOR LABOR IN THE SHELTERED SECTOR WHICH WOULD DRIVE UP LABOR COSTS IN, AND REDUCE RESOURCES ALLOCATED TO THE EXPOSED SECTOR. ON ANOTHER PLANE, CURRENT POLICY MAKERS HAVE EMPHASIZED PUBLICLY AND PRIVATELY TO US THEIR FEAR THAT TOO OFTEN FISCAL POLICY IN SWEDEN HAS TAKEN PLACE SO LATE IN THE BUSINESS CYCLE THAT LAGGED EFFECTS ACTUALLY COME INTO PLAY IN A PERNICIOUS, PRO-CYCLICAL MANNER. IF EXPORTS ARE DOING BETTER, AS WE BELIEVE, THERE IS CERTAINLY A JUSTIFICATION FOR CAUTION. AT THE SAME TIME, EXPORTS WILL DO BETTER ONLY IF THE OECD ECONOMIES MOVE UPWARD IN SOME CONCERT. THUS, IF SWEDEN AND THE OTHER OECD NATIONS DO NOT ALLOW REAL GROWTH OF IMPORT DEMAND TO ACCELERATE, THE INTERNATIONAL DEMAND ON WHICH SWEDEN INEVITABLY DEPENDS WILL NOT BE FORTHCOMING. THIS CIRCULAR ARGUMENT FOR INTERDEPENDENCE CANNOT HAVE ESCAPED THE SWEDES. THE SWEDES HAVE, OF COURSE, ALREADY TRIED TO ESCAPE THE RECENT (?) INTERNATIONAL RECESSION BY DOMESTIC STIMULATION AND CAN EASILY ARGUE THAT THEY HAVE ALREADY MADE THEIR CONTRIBUTION TO OECD GROWTH IN 1975 AND 1976 WHEN OTHERS ALLOWED UNEMPLOYMENT TO JUMP. FURTHER, GIVEN DOMESTIC POLITICAL CONSTRAINTS, WE CANNOT CONCEIVE OF A SWEDISH GOVERNMENT WHICH WOULD ALLOW THE UNEMPLOYMENT RATE TO EXCEED THREE PERCENT FOR MORE THAN A FEW MONTHS.

18. TO CONCLUDE, THE SWEDES DO HAVE SERIOUS PROBLEMS WITH INFLATION AND WITH EXTERNAL BALANCE. THEY ALSO HAVE VERY SERIOUS MEDIUM TERM PROBLEMS WHICH WE HAVE ADDRESSED ELSEWHERE. NEVERTHELESS, LIGHT IS VISIBLE IN THE DARKNESS, AND THE DANGER NOW APPEARS TO BE MORE ON THE DOWN SIDE THAN ON THE UP. THE ECONOMY CAN BE STIMULATED WITHOUT SERIOUSLY DAMAGING THE GOAL OF RELATIVE PRICE STABILITY OR CURRENT ACCOUNTS BALANCE AT SOME TIME IN THE MID-1980'S. WE SUGGEST THE US FOLLOW
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THIS LINE OF APPROACH IN QUESTIONING SWEDEN AT THE EDRC MEETING ON MARCH 15, AND THAT WE PUSH FOR SOME SUCH RECOMMENDATION IN THE FINAL SURVEY OF THE SWEDISH ECONOMY. WE ARE UNLIKELY TO BE SUCCESSFUL, BUT WE WILL HAVE HELD THE SWEDES' NOSE TO THE INTERDEPENDENCE GRINDSTONE, AND SET AN EFFECTIVE PRECEDENT.

19. PLEASE NOTE, THE ABOVE DOES NOT PRETEND TO BE AN EXHAUSTIVE ANALYSIS OF THE SWEDISH ECONOMY. WE HAVE

CHOSEN TO EMPHASIZE WHAT WE BELIEVE ARE THE KEY
DEVELOPMENTS AND WHICH SEEM OPPORTUNELY TO FIT IN WITH
US POLICY. MORE EXHAUSTIVE MATERIAL IS AVAILABLE IN
VARIOUS PUBLICATIONS SUBMITTED UNDER THE CERP PROGRAM AND
IN REPORTS CITED ABOVE.
KENNEDY-MINOTT

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, ECONOMIC PROGRAMS, RELATIONS WITH REGIONAL ORGS
Control Number: n/a
Copy: SINGLE
Draft Date: 10 mar 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978STOCKH00986
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D780108-0642
Format: TEL
From: STOCKHOLM
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t19780380/aaaacpqr.tel
Line Count: 716
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: f2db18c9-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 14
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 77 STOCKHOLM 3727, 77 STOCKHOLM A-188
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 27 apr 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3366474
Secure: OPEN
Status: NATIVE
Subject: THE SWEDISH ECONOMY IS READY TO JOIN THE OECD "CONVOY"
TAGS: EFIN, SW, OECD
To: STATE TRSY MULTIPLE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/f2db18c9-c288-dd11-92da-001cc4696bcc
Review Markings:
Sheryl P. Walter
Declassified/Released
US Department of State
EO Systematic Review
20 Mar 2014
Markings: Sheryl P. Walter Declassified/Released US Department of State EO Systematic Review 20 Mar 2014